

**MINUTES  
REGULAR MEETING  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, February 15, 2008  
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Michael Townsend, Chair of the ASRS Board, called the meeting to order at 8:32 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Mr. Michael Townsend, Chair  
Dr. Keith Meredith, Vice Chair (arrived at 8:36 a.m.)  
Mr. Dave Byers  
Mr. Tom Connelly  
Mr. Chris Harris  
Mr. Jaime Gutierrez (Via Teleconference)  
Mr. Steve Zeman

Absent: Mr. Lawrence Trachtenberg  
Mr. Jim McLaughlin

A quorum was present for the purpose of conducting business.

**2. Approval of the Consent Agenda**

**Motion:** Mr. Steve Zeman moved to approve Refunds, Death Benefits and Retirements and for the month of December, 2007;

*And*

Approve System Transfers for the month of January, 2008;

*And*

Approve the minutes of the December 21, 2007, Regular Session of the ASRS Board.

Mr. Chris Harris seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, and 3 excused, the motion was approved.

### **3. Approval, Modification or Rejection of Recommended Administrative Law Judge's Decisions**

Mr. Townsend asked Mr. Tom McClory, Assistant Attorney General, for a summary of Mr. Moses Long's appeal. Mr. McClory explained that Mr. Long had requested Long Term Disability (LTD) due to injuries he claimed he sustained while on the job in 2002. Mr. McClory said the claim did not arise until April of 2007 when Mr. Long consulted a podiatrist. Mr. McClory stated that there was no evidence of injury or disability and the medical records from other medical evaluations had not shown any evidence that Mr. Long was disabled while he was still an active ASRS member.

Mr. Townsend asked if Mr. Long was present either telephonically or in person, but Mr. Long was absent. Mr. McClory stated the Board could vote to accept the ruling of the Administrative Law Judge, reject the ruling or modify the ruling.

**Motion:** Mr. David Byers moved to accept the ruling of the Administrative Law Judge and deny Mr. Long's appeal.

Mr. Steve Zeman seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, and 3 excused, the motion was approved.

Dr. Keith Meredith arrived at 8:36 a.m.

As Mr. Townsend was preparing to move to the next agenda item, Mr. McClory noted that Mr. Long had arrived and was ready to address the Board. Mr. Townsend asked whether the motion should be rescinded and Mr. McClory said the Board could take Mr. Long's statement and then withdraw or revise the original motion.

Mr. Long stated he had consulted a doctor and the doctor was requested to fax a letter to the ASRS. Mr. McClory indicated that no letter had been received. Mr. Long then read a letter into the record.

After Mr. Long's presentation, it was the consensus of the Board the letter did not provide any additional information or evidence to alter the facts in the appeal. By consensus, the Board decided to let the original motion stand.

### **4. Presentation, Discussion and Appropriate Action Regarding the 2008 ASRS Legislation**

Mr. Pat Klein and Ms. Lesli Sorensen addressed the Board regarding the 2008 ASRS legislation. Ms. Sorensen provided a brief update highlighting bills of interest.

**Motion:** Mr. Steve Zeman moved to direct Staff to work with the Legislature to make an amendment to House Bill 2127 to provide that interest shall be paid retroactively, if applicable, to the type of benefit paid, if a person returns to collect abandoned monies.

Mr. Chris Harris seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Ms. Sorensen then gave an update on political races that may have an impact on the ASRS.

**5. Presentation, Discussion and Appropriate Action Regarding the Arizona State Retirement System's Comprehensive Annual Financial Report (CAFR)**

Mr. Cory Arvizu, Partner, and Mr. Neil Galassi, Lead Auditor, of Heinfeld, Meech and Company addressed the Board regarding the ASRS' CAFR. Mr. Arvizu said Heinfeld Meech issued and unqualified Independent Auditor's Report for the fiscal year ending June 30, 2007. He stated the audit performed for the report showed no significant issues with the ASRS financial accounting protocols.

Mr. Galassi gave a synopsis of the audit and mentioned that since this was the first year Heinfeld Meech had performed an audit of the ASRS, the audit was thorough and comprehensive. He said there were significant communications with the ASRS and all staff members were cooperative and helpful.

Mr. Arvizu indicated that there had not been and was no need to request a meeting with the Board with staff absent.

**6. Presentation, Discussion and Appropriate Action Regarding the Contract of Franklin Portfolio Associates and State Street Global Advisors, ASRS U.S. Equity Large Cap Managers**

Mr. Gary Dokes, Chief Investment Officer, addressed the Board regarding the status of Franklin Portfolio Associates and State Street Global Advisors, ASRS U.S. Equity Large Cap Managers. Mr. Dokes indicated there were several reasons why the Investment Management Division (IMD) was recommending the termination of these two managers.

With regard to Franklin Portfolio Associates, the concern was over Franklin's quantitative stock selection model and the anticipation of continued poor portfolio performance relative to their S&P 500 Index Bookmark. For State Street, the concern was over significant organizational changes, the ability of State Street being able to add value moving forward and a risk of litigation the firm faces due to the performance of its active U.S. fixed income strategies during 3Q2007.

Mr. Dokes indicated the rationale for transitioning the Franklin and State Street portfolios to E2 was based on the move providing far more efficient cash flow management and providing the opportunity to generate incremental alpha with low active risk.

**Motion:** Mr. Chris Harris moved to terminate Franklin Portfolio Associates and State Street Global Advisors, ASRS U.S. Equity Large Cap Managers;

*And*

Transition both portfolios, whose aggregate market value is approximately \$970 million, to E2, ASRS' passive U.S. Large Cap Equity portfolio.

Mr. Tom Connelly seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

## **7. Presentation, Discussion and Appropriate Action Regarding U.S. Small Cap Equity Asset Class Reporting for the Quarter Ending 12/31/07**

Mr. Gary Dokes, Ms. Sarah Wadsworth, Senior Portfolio Analyst, and Mr. Terry Dennison, Worldwide Partner, Mercer Consulting, addressed the Board regarding the U.S. Small Cap Equity Asset Class reporting for quarter ending December 31, 2007. Mr. Dokes stated that as of December 31, 2007, the total market value of the ASRS Small Cap asset class was \$1.8 billion and represented approximately 7% of the ASRS total fund. As of December 31, 2007 Small Cap Equity assets were managed in three portfolios: two active portfolios and one passive portfolio.

## **8. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview for Quarter Ending 12/31/07**

Mr. Terry Dennison addressed the Board regarding the Total Fund Performance Overview for the period ending December 31, 2007, highlighting specific areas of interest and concern.

Mr. Dennison reported on the Total Fund Performance for the period ending December 31, 2007.

	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>	<b>Inception</b>
<b>Total Fund</b>	6.6%	9.0%	12.5%	7.7%	10.9%
<b>Benchmark*</b>	8.1%	9.3%	12.2%	6.8%	10.7%
<b>Excess Return</b>	-1.5%	-0.3%	0.3%	0.9%	0.2%

\* Interim Benchmark (current): 39% S&P 500, 7% S&P 400, 7% S&P 600, 27% LB Aggregate, 19% MSCI ACWI ex US, and 1% NPI+100 bps.

Note: Interim Benchmark incorporates a proration of 5% real estate and 5% private equity.

Policy History:

- 7/1/75-12/31/79 – 40% S&P 500/60% LB Aggregate
- 1/1/80-12/31/83 – 50% S&P 500/50% LB Aggregate
- 1/1/84-12/31/91 – 60% S&P 500/40% LB Aggregate
- 1/1/92-12/31/94 – 50% S&P 500/40% LB Aggregate/10% EAFE
- 1/1/95-6/30/97 – 45% S&P 500/40% LB Aggregate/15% EAFE
- 7/1/97-12/31/99 – 50% S&P 500/35% LB Aggregate/15% EAFE
- 1/1/00-9/30/03 – 53% S&P 500/30% LB Aggregate/17% EAFE
- 10/1/03-12/31/06– 53% S&P 500/26% LB Aggregate/15% MSCI EAFE/ACW ex. US(1)/6% NCREIF+100 bps.
- 1/1/07 – present – 31% S&P 500/7% S&P 400/7% S&P 600/26% LB Aggregate/18% MSCI ACWI ex US/6% NPI+100 bps/5% Russell 3000+300 bps

(1) MSCI EAFE/ACW ex. US Benchmark is the MSCI EAFE prior to 10/1/05 and the MSCI ACW ex. US thereafter.

## **9. Presentation, Discussion and Appropriate Action Regarding the Review of the 2007 Strategic Initiatives of the ASRS**

Mr. Paul Matson addressed the Board regarding the 2007 Strategic Initiatives of the ASRS. He gave a brief overview of the prior year's strategic initiatives. He stated there was a "post mortem" review of the items which was necessary to make sure the items were appropriate and successful. He also stressed the strategic initiatives were always high level, of critical importance to success of the agency, and typically having completion dates.

## **10. Presentation, Discussion and Appropriate Action Regarding the 2008 Strategic Initiatives**

Mr. Matson addressed the Board on the 2008 Strategic Initiatives of the ASRS. He pointed out that the number of initiatives had increased to 11, pointing out the difference between the 2007 list and the 2008 list. He also gave an overview of the initiatives, including time frames and key elements.

Members of the Board offered comments and asked questions about the initiatives including where certain initiatives should be placed on the list, staffing issues and concerns, and communications with members and retirees including a communications strategy.

Dr. Keith Meredith requested that another strategic initiative be included for 2008. This strategic initiative would be an analysis and dissemination of the success of the final IT projects. Mr. Byers requested the section on Investment Program Development be moved closer to the top of the list of strategic initiatives.

**Motion:** Mr. Chris Harris moved to accept the proposed strategic initiatives for calendar year 2008 including recommendations regarding the initiative with respect to the analysis and dissemination of the success of the final IT project.

Mr. Steve Zeman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

## **11. Director's Report**

Mr. Paul Matson added the following comments to the Director's Report:

1. The Legislative Budget Office initiated a recalculation of and increase to the current year's (FY08) funding for employee-related expenses. ASRS staff had previously identified a several hundred thousand dollar shortfall in this area and initiated a "soft" hiring freeze to ensure the agency would not exceed its appropriation. As a result of the Joint Legislative Budget Committee's action, the hiring freeze has been modified, and some modest service issues caused by the freeze can be addressed.
2. Although the IT Plan will conclude at the end of June 2008, staff has successfully set aside approximately \$1 million to address any unmet requirements or performance issues that arise whenever an effort of this size and scope is concluded. Additionally, the possibility

remains that after these issues are addressed, a small residual balance will be left and reverted to ASRS Plan assets.

3. The ASRS did a recent analysis on trading controls for the agency and that analysis will be presented at the next Operations Committee meeting.
4. Mr. McClory was recently recognized by the Arizona Attorney General with a 30-year Career Service Award.

## **12. Possible Presentation Regarding Board Committee Updates**

Mr. Jaime Gutierrez, Chair, External Affairs Committee (EAC), stated that the next EAC meeting would be in March, 2008 and will include additional updates on legislative matters.

Mr. Chris Harris, Vice Chair, Investment Committee (IC), said and IC meeting has been scheduled for March, 2008 and will include the issue of Board Governance.

Mr. Dave Byers, Chair, Operations Committee (OC), stated that there would be an OC meeting in February, 2008.

## **13. Board Requests for Agenda Items**

There were no requests for future agenda items.

## **14. Call to the Public**

Mr. William Peltier, Retiree, addressed the Board on the Permanent Benefit Increase (PBI). Mr. Peltier said he has seen the ASRS have returns of 14% on its investments but there is no indication that the excess returns are being set aside for the PBI fund so that retirees can get a PBI. Mr. Matson reminded the Board the return numbers quoted are annual, but the PBI fund structure and set asides are based on the actuarial methods that smooth returns over time.

## **15. The next ASRS Regular Board meeting is scheduled for Friday, March 21, 2008, at 8:30 a.m., at 3300 N. Central Avenue, 10<sup>th</sup> Floor Board room, Phoenix, Arizona.**

## **16. Adjournment of the ASRS Board**

Mr. Townsend adjourned the February 15, 2007 Board meeting at 11:23 a.m.

ARIZONA STATE RETIREMENT SYSTEM

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Zachary Kucera, Secretary

Date

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Paul Matson, Director

Date